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POLICY RESEARCH WORKING PAPER

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Interregional Resource Transfer and Economic Growth in Indonesia

Toshihiko Kawagoe

Rapid economic growth in Indonesia starting in the 1970s was fueled by market-based resource transfers, which helped modernize regional economies, creating the driving force for industrialization; and more welfare-oriented government-based resource transfers, or development spending, which favored the poorer outer islands.



Summary findings

In 1970, Indonesia was a poor agricultural state, with a per capita GNP of only US\$80 — the lowest among Asian economies and substantially lower than such African countries as Kenya and Ghana. Agriculture — with about 50 percent of GDP and 66 percent of the labor force — was the dominant sector.

In the 1970s, however, Indonesia showed rapid economic growth (5 percent a year). Softened world oil markets brought a slowdown in growth in the early 1980s, but growth recovered and per capita GNP in 1994 was US\$880, comparable with the Philippines and substantially higher than many South Asian and African countries. Agriculture had only a 22 percent share of GDP; industry, 41 percent; and services, 42 percent.

But Indonesia is enormously diverse and some parts of it did much better economically than others. As the

country's economy grew, market-based resource transfers helped modernize regional economies, creating the driving force for industrialization. By contrast, government-based resource transfers, in the form of development spending, were more welfare-oriented, favoring the poorer outer islands (and did not contribute to industrialization).

In other words, economic growth was sustained by two driving forces, government- and market-based transfers, which complemented each other. The oil boom was a bonanza, producing new fiscal revenue, a luxury only oil-exporting countries could enjoy. It is not always a ticket to successful industrialization, as the tragic experiences of such oil-exporting economies as Mexico show.

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Toshihiko Kawagoe

Faculty of Economics, Seikei University**

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** 3-3-1 Kichijoji-Kitamachi, Musashino-shi, Tokyo 180 Japan.

e-mail kawagoe@econ.seikei.ac.jp Fax: +81-422-37-3874 Tel: +81-422-37-3584

Inter-regional Resource Transfer and Economic Growth in Indonesia¹

Toshihiko Kawagoe

Faculty of Economics, Seikei University

1. Introduction

In 1970 Indonesia was one of the low income countries having only a GNP 80 US dollars per capita, which was the lowest among Asian economies and substantially lower than that of African countries, such as Kenya and Ghana.² Like other low income economies, agriculture was the most dominant sector in the Indonesian economy, occupying around 50 percent of the GDP and 66 percent of the total labor force.

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² Per capita GNP in 1970 U.S.\$, shown in the parentheses, was Ghana (250), Kenya (130), India (110), Bangladesh (100), Philippines (230) and Thailand (210). Source: World Bank, *World Table 1992*, Table.1.

